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Supreme Court of the United States

OCTOBER TERM, 1946.

749408
Sup. Ct

No. **1214**

AMERICAN POWER & LIGHT COMPANY

AND

FLORIDA POWER & LIGHT COMPANY,
Petitioners,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE
FIRST CIRCUIT. BRIEF IN SUPPORT THEREOF.

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April 3, 1947.



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**PETITION FOR WRIT OF CERTIORARI TO THE UNITED
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*To the Honorable, the Chief Justice of the United States
and the Associate Justices of the Supreme Court of
the United States:*

American Power & Light Company and Florida Power & Light Company pray that a writ of certiorari issue to the United States Circuit Court of Appeals for the First Circuit to review the decree of that Court entered in the above-entitled cause on December 9, 1946, affirming an order of the Securities and Exchange Commission (hereinafter referred to as the Commission), dated December 28, 1943, and an order of that Commission denying Petitioners' Application for Rehearing, dated January 12, 1944.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 24(a) of the Public Utility Holding Company Act of 1935 (49 Stat. 803, 834-5; 15 U.S.C. §79x(a)) and Section 240(a) of the Judicial Code, as amended (28 U.S.C. §347(a)).

The Opinions Below.

The opinion of the Circuit Court of Appeals for the First Circuit was rendered on December 9, 1946 and is reported at 158 F. (2d) 771. The opinion appears at R. 2002-2025 in Volume V.

The opinion of the Commission rendered December 28, 1943, the order of the same date, and the order denying the Petitioners' Application for Rehearing dated January 12, 1944, have not been officially reported. The portions of the order of the Commission which form the basis of this Petition appear at R. 102.

Statute Involved.

The statute involved is the Public Utility Holding Company Act of 1935 (49 Stat. 803, 15 U.S.C. §79), hereinafter referred to as the "Act". The portions of that Act which are directly involved are Sections 15(f) and 20(a) thereof (15 U.S.C. §79o(f) and §79t(a)).

Section 15(f) provides:

"All accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records kept or required to be kept by persons subject to any provisions of this section shall be subject at any time and from time to time to such reasonable periodic, special, and other examinations by the Commission, or any member or representative thereof, as the Commission may prescribe. The Commission, after notice and opportunity for hearing, may prescribe the account or accounts in which particular outlays, receipts, and other transactions shall be entered, charged, or credited and the manner in which such entry, charge, or credit shall

be made, and may require an entry to be modified or supplemented so as properly to show the cost of any asset or any other cost."

Section 20(a) provides:

"The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this chapter, including rules and regulations defining accounting, technical, and trade terms used in this chapter. Among other things, the Commission shall have authority, *for the purposes of this chapter*, to prescribe the form or forms in which information required in any statement, declaration, application, report, or other document filed with the Commission shall be set forth, the items or details to be shown in balance sheets, profit and loss statements, and surplus accounts, the manner in which the cost of all assets, whenever determinable, shall be shown in regard to such statements, declarations, applications, reports, and other documents filed with the Commission, or accounts required to be kept by the rules, regulations, or orders of the Commission, and the methods to be followed in the keeping of accounts and cost-accounting procedures and the preparation of reports, in the segregation and allocation of costs, in the determination of liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the keeping or preparation, where the Commission deems it necessary or appropriate, of separate or consolidated balance sheets or profit and loss statements for any companies in the same holding company system."

Summary Statement.

American Power & Light Company (hereinafter called "American"), a Maine corporation, registered as a holding company under the Act in 1938.

Florida Power & Light Company (hereinafter called "Florida") is a Florida corporation.

American owns directly and indirectly practically all the common stocks and some other securities of 13 corporations, of which 11 are operating electric (and, in a few instances, gas) public utilities. American owns all the common stock of Florida. The Commission has ordered American to dispose of its holdings and to dissolve. *American Power & Light Co. and Electric Power & Light Corp. v. Securities and Exchange Commission*,—U.S. —; 91 L. Ed. (Adv. Op.) 89.

Florida is an operating electric and gas utility conducting its business solely in the State of Florida.

The Commission by its order of July 10, 1941, which initiated the proceedings before the Commission, raised issues which included "the necessity for stopping dividends on preferred and common stocks held by American * * *."

In the proceedings below, the Commission made a finding that the sum of \$1,815,655 of Florida's plant account represented profits (principally a 4% construction charge) realized by affiliates (other than American) on engineering and construction services rendered to Florida (R. 108-109) and, without regard for the demonstrated reasonableness of the payments, ordered the elimination from Florida's plant account of the costs represented by the payments by charge to earned surplus (R. 99). The items going to make up the \$1,815,655 are hereinafter sometimes referred to as the Account 107 items.

The Commission also made a finding that the actual arm's length cost of Florida's assets to it might ultimately be found to be as much as \$10,500,000 in excess of the original cost of those assets to the person who first placed them in public service (R. 93) and, without determining what the actual costs represented, ordered Florida to prepare for their ultimate expurgation from Florida's books, by removing annually from earned surplus to a contingency reserve, the sum of \$700,000 (R. 102). The items going to make up the \$10,500,000 are hereinafter sometimes called the Account

100.5 items. Since three years have elapsed from the effective date of this part of the order, its effect has been to remove from surplus, otherwise available to American as dividends, the sum of \$2,100,000.

Petitioners state factually, not as argument, that there is no evidence in the record to the effect that any part of the \$10,500,000 represents "fictitious or paper increment" or that the sum does not represent "an investment which the accounting company has made in assets of continuing value" or that the assets thereby represented have ceased to exist or have been retired.

The record does show that the entire sum is the excess of actual arm's length cost over "original cost".

American filed its petition in the Circuit Court of Appeals for the First Circuit and Florida filed its Petition for Review of these orders by the United States Circuit Court of Appeals for the Fifth Circuit.

On June 19, 1944, the Circuit Court of Appeals for the First Circuit issued its opinion directing that Petitioner's Petition for Review be dismissed upon the ground that the Petitioner, in effect, was not a "person or party aggrieved" within the meaning of Section 24(a) of the Act. 143 F. (2d) 250. Upon certiorari, this Court on June 4, 1945, reversed (325 U. S. 385), holding that the order now before this Court (p. 389) "* * * has a direct adverse effect on American as a stockholder entitled to dividends * * *."

On December 9, 1946, the Court below affirmed, 158 F. (2d) 771, both portions of the Commission's Order, the Court holding (1) as to the Account 100.5 items, that as no definitive order of disposition was involved, preliminary findings (indicating a probability that the Commission would in the future require that a substantial portion of the items be written off against income or operating expense account) were sufficient to warrant the appropriations from surplus to a contingency reserve, and (2) as to the Account

107 items, that without regard to the rule of reasonableness, and under a cost system of accounting, costs giving rise to profits in transactions between affiliates must be eliminated from the books by a charge to earned surplus.

It must be recognized that there would be no point at all in requiring the removal of these sums from earned surplus to a contingency reserve unless the Commission were empowered to cause the restatement of the assets to reflect "original cost" instead of actual cost.

Because the Commission's Order and the opinion of the Court below are directed to the two separate items of account, the remainder of this Petition is so separately directed.

The Questions Presented.

As to the Account 100.5 Items:

1. Is the order of the Commission, having a direct adverse effect on the stockholder of a corporation by requiring that the corporation make provision, by charges against surplus, to write off and eliminate from its books items representing actual arm's length cost, in the absence of findings based on substantial evidence that such items are improperly in the asset accounts, valid under the Constitution of the United States?

2. Is the Commission empowered by the Act to require a corporation to remove from its earned surplus amounts otherwise available to its stockholders as dividends, for the ultimate purpose of reforming the asset accounts to substitute the cost of those assets to some prior owner for and instead of the actual cost of those assets to the corporation itself?

As to the Account 107 Items:

1. Is the order, based on the theory of "no-profits between affiliates", upon a record which demonstrates (a) that the profits were fair and reasonable, (b) that the

profits were never received by the stockholder adversely affected and (c) that the stockholder and the recipient of the profits were owned by different groups of investors, valid under the Fifth Amendment to the Constitution of the United States?

2. Is the Commission empowered by the Act to require a corporation to remove amounts otherwise available to its stockholders as dividends from its earned surplus, for the purpose of eliminating from the asset accounts costs representing reasonable payment for services received, merely because the recipient was affiliated with the stockholder?

Specification of Errors to be Urged.

1. As to the opinion of the Court below in so far as it related to the Account 100.5 items, the Court erred in affirming the Commission's order

(a) because the Opinion ignores the fact that the order in its present form (not some future definitive order based on evidence and findings), "has a direct adverse effect upon American as a stockholder entitled to dividends", 325 U. S. 385, 389;

(b) because the Opinion ignores the fact that the Order was based on the Commission's concept of possibilities and probabilities, as distinguished from evidence and findings;

(c) because the Order was issued in the absence of legislative authority or direction to require Florida to alter its earned surplus account for the sole and unauthorized purpose of bringing about ultimate substitution of "original cost" for actual cost in its asset accounts;

(d) because the Order has the effect, arbitrarily and unconstitutionally, of diverting from the stockholder (which may soon be public investors at large) income

and surplus lawfully earned and available for dividends, to the unauthorized purpose of recasting the asset accounts; and

(e) because the Order imposes such a measure of just plain bad accounting,—the kind that falsifies and does not reflect the facts,—that it is arbitrary and capricious.

2. As to the Opinion of the Court below in so far as it related to the Account 107 items, the Court erred in affirming the Commission's Order

(a) because the Order is based on the erroneous conclusion that the rule of the "licensee" cases under the Federal Power Act, (involving license contracts) as well as a legislative direction to set "recapture" prices at "actual legitimate original cost" and illustrated by *Pennsylvania Power & Light Company v. Federal Power Commission*, 139 Fed. 2d 445, certiorari denied 321 U.S. 798, is applicable to the facts in this case;

(b) because the Order is based on the erroneous conclusion that "profits between affiliates are illegitimate items of cost" without regard to the degree of affiliation and the reasonableness of the payments;

(c) because there is no legislative authority or direction to the effect that solely because costs were incurred in transactions between affiliates, they must be denied accounting recognition;

(d) because the record here shows the major part of the Account 107 amounts represented payments to affiliates which were proportionately less than actual payments for identical construction services made contemporaneously to non-affiliated interests and were less than the scale of payments adopted by the Association of General Contractors and because of the absence of any showing that there was any fraud or overreaching in connection with the transactions;

(e) because it has the arbitrary effect of making the stockholder pay sums to Florida which the stockholder never received and which in fact were paid to companies which are owned by investors different from the owners of American;

(f) because it is predicated upon the false assumption, contradicted by the record, that American, and the affiliated companies to which the payments were made, were the same corporate entities;

(g) because of the absence of any requirement of the Uniform System of Accounts, itself promulgated by the Commission, that payments in transactions between affiliates, however reasonable, be denied recognition as cost.

3. The Court erred in affirming the portions of the Order here attacked because upon the facts in this case the Commission exceeded its statutory authority and deprived Petitioners of property in contravention of Amendment V to the Federal Constitution. Furthermore, Sections 15(f) and 20(a) of the Act are not authorized as regulations of commerce or as being on the subject of bankruptcies, nor for the establishment of post offices or post roads. Sections 15(f) and 20(a) invade powers reserved to the states by Amendment X to the Constitution.

4. The Court below erred in denying Petitioners' petition for rehearing.

Reasons Relied On for Grant of Writ.

(1) Whether, under the Act here involved, a corporation can be required, to the detriment of its stockholders, to make provision for restating its asset accounts to reflect, instead of the actual cost of those assets to it, the yet-to-be-determined cost thereof to some prior owner, is an im-

portant Federal question which has not been, but ought to be, settled by this Court.

(2) The Court below, in affirming the Order of the Commission without requiring clear and definitive administrative findings as a basis for the substantial action required by the Order, probably failed to give effect to the holding of this Court (325 U.S. 385), that the Order in its present form had a direct adverse effect on American, one of the Petitioners herein and probably departs from the principles illustrated by *Colorado-Wyoming Gas Company v. Federal Power Commission*, 324 U.S. 626, as to the necessity for clear and definite administrative findings.

(3) The Opinion below is probably in conflict with *American Telephone & Telegraph Company v. United States*, 299 U.S. 232, in that here the administrative order actually does require substantial restatement of accounts in the absence of supporting evidence and findings but upon an expectation or speculation that in the future evidence will be adduced and findings made which will support such restatement.

(4) Whether or not, under the Act here involved, a rule of absolute non-recognition of profits in dealings between affiliated entities is to be applied, is likewise an important federal question, as such a rule appears to be in conflict with previous decisions of this and many other courts and with the general practice of departments of federal government and business generally.

(5) A real question of present and current deprivation of property without due process of law in violation of the Fifth Amendment to the Federal Constitution is presented, inasmuch as Petitioners are sustaining direct adverse effects of the administration action, taken in administrative expectation of, but without basis either in existing evidence or in clear and definite findings

WHEREFORE, for the reasons stated above and discussed more fully in the annexed brief, your Petitioners pray that a writ of certiorari be issued out of and under the seal of this honorable Court, directed to the United States Circuit Court of Appeals for the First Circuit, to the end that the above cause may be certified to and reviewed and determined by this Court and that the judgment of said Circuit Court of Appeals in the above-entitled cause may be reviewed by this Court, and your Petitioners pray for such other and further relief as this Court may deem just and proper.

Respectfully submitted,

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April 3, 1947.

Supreme Court of the United StatesOCTOBER TERM, 1946.

No.

AMERICAN POWER & LIGHT COMPANY**AND****FLORIDA POWER & LIGHT COMPANY,**
*Petitioners,**against***SECURITIES AND EXCHANGE COMMISSION,**
Respondent.

BRIEF IN SUPPORT OF PETITION

A principal uncertainty about the correctness of the Opinion below is that it assumes that future administrative action will be taken after a future hearing and upon evidence which may or may not be adduced to support such future action.

In the meantime, the Petitioners sustain adverse effects which may never be remedied. Particularly, American shortly will lose its status as stockholder of Florida under the impact of the act. *American Power & Light Co. and Electric Power & Light Corp. v. Securities and Exchange Commission*, — U.S. —; 91 L. Ed. (Adv. Op.) 89.

The Opinion below assumes the legality of such action, although in no previous proceeding has this Court passed upon:

(1) the question of the authority of the Commission, under the Act here involved which differs materially from other regulatory acts, to impose "original cost" accounting; and

(2) the question of the authority of an administrative tribunal to require substantial alteration of rights in anticipation of future administrative action, the evidentiary basis for which admittedly has not been laid.

The real basis of the Opinion below lies in the assumption that, as to the Account 100.5 items, so long as no final disposition of cost accounts has been ordered, the parties can be required to proceed as if such final disposition had been determined adversely to the contentions of the Petitioners on all points of fact and law. The effect is to apply the assumption to remove from Florida's surplus millions of dollars and withhold them from American when American otherwise, under the facts and laws of the State of Florida, is entitled to receive them as they become available.

In other words, the order amounts to a final determination, at this stage of the proceedings, that in the years 1944, 1945, 1946 and 1947, American must forego dividends in the amount of \$2,800,000, or entirely, if it should cease to be a stockholder before the matter is finally settled through the application of due process of law.

The Court below thought the Commission's findings "were sufficiently within the spirit of the doctrine of the *American Telephone & Telegraph* case to support the order requiring a contingency reserve to be accumulated to offset probable write-offs of the amounts eventually to be classified in Account 100.5." But the administrative facts in the *American Telephone & Telegraph* case were that the Company was not required to remove any portion of its surplus

to any reserve. The whole machinery of administrative action came to a standstill pending final administrative determination after investigation of all the facts.

Even the Uniform System of Accounts prescribed by the Commission itself makes no provision for any such interim effect on substantive rights.

In any event, it cannot be gainsaid that this aspect of the case is one of first impression in this Court and requires resolution.

As to the Account 107 items, this Court has never applied the rule of absolute non-recognition of profits in transactions among affiliates under this or any other Act. The question has never been squarely before the Court, particularly under this Act. It was not squarely before the Court in *United States v. New York Telephone Company*, 326 U. S. 638, where the Court held that upon the basis of a full hearing on the precise question of the validity of the items as cost, it had been finally found that the transaction involved nothing but a bare transfer of title to property from one affiliate to another, the creation of no new thing of value and no change in function of the property.

This application of the rule of absolute non-recognition is confusing to the whole business economy.

This Court knows that the Bureau of Internal Revenue gives full recognition to costs incurred in inter-affiliate transactions in absence of a showing of fraud or over-reaching.

Similarly, in connection with the renegotiation of War and Navy Department contracts, the regulations provide as to dealings between affiliates that "The net cost of such purchases should not be greater than it would have been had they been made from others".

The confusion introduced into the general economy by application of the absolute non-recognition doctrine should be removed by the determination of this Court.

Conclusion

It is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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April 3, 1947.